Go: Investing for Impact- the early years

In August of 2007, the Portfolio Management Team (PMT) presented a fully-detailed plan of action to the Foundation Board. The team provided information on how it would launch and operate the mission-driven investing program, including the management and oversight structure proposed for the program.

At the close of the presentation, the PMT recommended the Board allocate $100 million endowment dollars for mission investing purposes. Operating on two separate platforms, one for the United States and one for southern Africa, the team committed to preserving principal plus achieving a minimum overall portfolio return of 4-6% net of fees.

The Board members supported the action-learning experiment and the structure and procedures that had been recommended. The Board asked that the team report to the Board's Finance Committee and that the full Board be updated annually on the mission-investing progress as well.

The first full mission-driven Investment Committee was convened in January of 2008. The meeting started with approval of a Policy Statement. Subsequent meetings were dedicated to other administrative details, including the approval of an annual work plan, a discussion of metrics, and investment strategies. Work has focused on:

- Developing a Cash Management Plan
- Executing Deals
- Initiating Market Scans
- Advancing the Work

Developing a Cash Management Plan

The centerpiece of the Kellogg Foundation's initial U.S. portfolio discussion was a cash management strategy through which the Foundation would commit dollars to short-term and intermediate-term cash deposits and fixed-income securities to banks and credit unions or fixed-income managers. These financial institutions would be selected based on their targeting of investment proceeds to community development in the Foundation's priority geographies and/or program areas.

The cash management strategy was opportunistic. The idea behind it was straightforward: The Foundation could generate immediate social impact by placing the funds in accounts serving low-income communities, with a ladder of varying maturities. As these accounts mature, the Foundation could reinvest the funds or recycle them to newly identified mission-driven opportunities for additional social impact.

Following the initial Investment Committee meeting, the committee authorized the PMT to place $22 million in federally insured bank deposits in Community Development Financial Institutions or similar banks in the priority geographies of Michigan, Mississippi, New Mexico and the Gulf Coast region. These institutions were screened using National Community Investment Fund metrics for their Development Loan Intensity and Development Deposits Intensity.

The Investment Committee also authorized the PMT to deposit a total $400,000 in four low-income designated credit unions where each deposit was fully covered by National Credit Union Administration insurance. Many of these low-income designated credit unions actively pursue community development missions and have received federal certification as Community Development Financial Institutions.

Executing Deals

Simultaneous to making the cash deposits, the Portfolio Management Team continued to build its deal strategy.

The process of deal sourcing and pipeline development included a triaging function to screen deals that did not fit with investment policy. Of course, the work was not without complications and challenges. While the cash management portion of the Kellogg Foundation's U.S. strategy was relatively easy to structure and price, other aspects of pipeline development, and program management were more difficult. Participants in this process identified the following early challenges and questions:

- **Can we keep the pipeline filled?** The challenge of building a pipeline that directly matches the Foundation's priority program areas and geographies reflects a social sector marketplace that is not yet fully aware of mission investments as a funding tool. While there has been a steady increase in mission investment products, education and consultants for interested foundations, there has not been a parallel effort to educate social sector organizations about how they might source, qualify for, and use mission investments in addition to or in place of grants.

- **Can we strike a balance?** The need to achieve benchmark financial returns by asset class, on the one hand, and providing financing on optimal terms to high-performing investees with strong mission alignment on the other hand.
- **Will we find enough deal flow focused on our mission?** All acknowledged that the mission-driven investment experiment would be deemed unsuccessful if it failed to achieve the financial objectives. Yet, also important was the reality that to be successful the experiment must test new investment approaches to solving social problems, particularly with a view to the Foundation's priority goals of improving the prospects of vulnerable children and countering such systemic barriers to equal opportunity as persistent racism. How robust would deal flow be in this "targeted space"?
- **Will we get enough investment referrals from program staff?** Staff certainly refer potential deals that are appropriate for program-related investing. This may limit the potential mission-driven investing deal flow from staff referrals, but might it also suggest intriguing potential for an expanded program-related investment program at the Kellogg Foundation?
- **Will mission-driven investing deals require too much time at current staffing levels?** Mission-driven investing deals may be complex and time-consuming to structure. How will we handle the methodical work process needs?
- **Will we be able to achieve our diversity objectives?** The Policy Statement specifically calls for "an emphasis on seeking racial and gender diversity among those who place the money, where the money is placed, and the communities that use it." Achieving diversity at all levels of the mission investing process requires persistent effort to identify and influence diverse professional teams.
- **Will the current economic situation affect our financial returns?** The Foundation launched its mission-driven investing program during one of the most severe economic contractions and credit crunches of the last 60 years. Even though the strategy targets market-rate financial returns for many asset classes, actual yields might well be less than anticipated—and credit risks higher due to current market conditions.

The Foundation entered the execution phase of this mission-driven investing program with a renewed sense of purpose. Even at this early stage, mission-driven investing was proving to be an ideal learning laboratory for the entire organization, providing new levels of experience for a diverse group of participants. The program was also a good embodiment of the Foundation's new framework for cross-functional collaboration, innovation, risk-taking, and action learning.

Initiating Market Scans

To ensure that investment decisions closely aligned with the Kellogg Foundation's programmatic framework, the PMT conducted competitive market landscape scans of investment opportunities within each priority area of education, food, health and well-being, and family economic security.

The first scan focused on an Education and Learning landscape. It was designed to survey the universe of potential investments and identify key opportunities, risks, strategic trade-offs, and potential co-investors. The landscape informed our mission-driven investing strategy and guided investment decisions going forward.

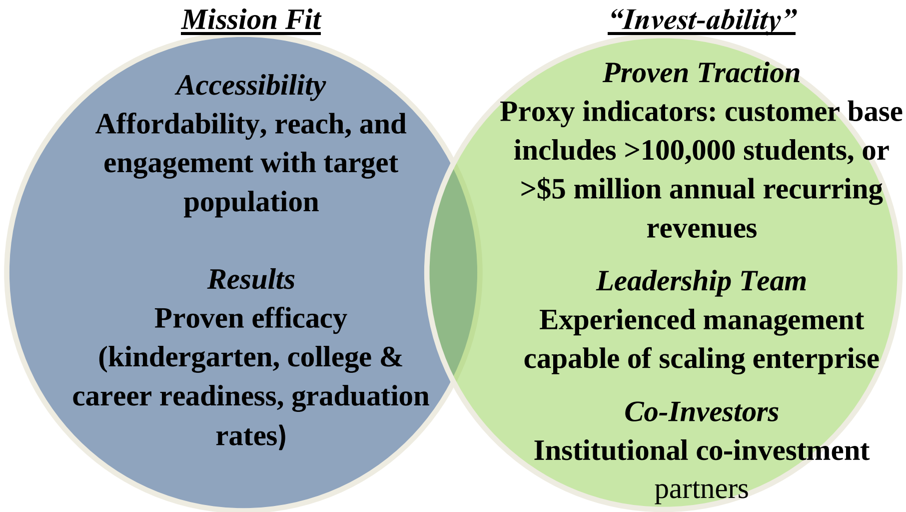
As a starting point for the landscaping process, the team asked: What is the role of mission-driven investing in Education and Learning?

- Is it to *scale up already existing innovations/enterprises?* If so, this is a less risky approach and mission-driven investing should have greater likelihood of being able to *reach significant numbers* of vulnerable children within five years.
- Is it to *catalyze "start up" innovations/enterprises?* If it is, the mission and financial risks increase and there is less likelihood of being able to reach significant numbers of vulnerable children within five years (i.e. start ups take time to grow and reach/impact numbers).

To formulate an Education and Learning mission and investment thesis, the PMT undertook several months of market research, including reviewing a universe of more than 580 education and learning enterprises, 100 potential investment partners and intermediary lenders, and seven broad venture subsectors of interest within Education and Learning. The list was screened down to 31 enterprises from which the PMT recommended a short list of five to the Investment Committee for deep diligence. The focus was on entities with the strongest potential to meet the key mission and financial criteria – innovative models propelling vulnerable kids forward that can generate attractive financial returns.

Key findings brought opportunities and risks into focus. Essentially, the team determined that they would pursue initial investments with enterprises that were beyond the "start up" stage in order to more quickly achieve impact objectives.

The Foundation's Education and Learning investment criteria are captured in the following diagram:



From this base of understanding, both a mission and financial thesis were developed leading to an Education and Learning investment strategy that established overall targets to guide our mission-driven investing in the first 12-24 months:

- **Direct venture capital** – Pursue two to three direct investments in enterprises in partnership with high-quality co-investors.
- **Venture fund** – Identification of one to two high-quality education-focused venture funds in which to invest and pool capital with other like-minded investors.
- **Financing** – Execution of one to three loans to provide working capital/facilities financing to educational management organizations and/or educational services organizations in conjunction with experienced lenders and/or intermediaries.

A similar process helped define the work within the Food, Health and Well-Being and Family Economic Security targets. All three of these landscape scans helped to connect and integrate mission-driven investing work with program staff. Each has been led by a program officer from the respective area.

The scans also have led to an informed investing strategy. While not all of the current investments in the Foundation's mission-investing portfolio directly relate to our scanning efforts (some were identified either prior to, or simultaneous to, the scanning process), the process and results have offered important guidance as we move forward to maximize impact and manage risk in targeted areas of priority for the Foundation.

Advancing the Work

Finally, the portfolio management team engaged in a range of supporting activities designed to advance their mission-driven investing work. These important activities fall under the headings *Social Metrics and Learning.*

Social Metrics

As noted earlier, social metrics are integral to each mission-driven investing transaction. Measuring social impact –otherwise known as "social metrics" under the lexicon du jour– remains a major challenge for social investing, if not for philanthropy in general. Behind the language debate, is yet another debate: How can we know that we are making a difference? And, in this era of decreased endowments, how can we know that we are having the greatest impact possible?

Enter dashboards—computer generated charts and graphs or "display devices" that measure real-time performance at a glance. Dashboards are growing in popularity because they can be designed to report a range of performance measures for mission investments--or for grants.

The W.K. Kellogg Foundation's mission-driven investing program is testing whether and how strategically selected financial investments across asset classes can generate investment returns of 4-6% (net of all costs and fees) while driving social change consistent with the Foundation's mission. In that context the dashboard tracked both financial and social data with a view to assist Kellogg's early evaluation of performance along each of these "double bottom lines." While it was not a do-it-all tool, the dashboard captured common data elements for all investments and provided an overview of aggregated metrics of both financial and social returns.

The mission-driven investing dashboard tracks the following information for each investment:

- Investment (name of organization or fund)
- Asset class (cash, fixed income, private equity, and real estate)
- Amount
- Due Date (maturity or term)
- Ownership Stake (percentage of venture held by the Kellogg Foundation)
- Financial Return (contractual or expected range)
- Strategy (Education, Wealth Creation, Place Based, or Program Director-Generated)
- Geography (Priorities for mission-driven investing: Michigan, New Mexico, Mississippi, and New Orleans)

- Products and Services (number and/or dollar amount)
    - Family Economic Security/Wealth Creation
        - Capital available to low to moderate income communities
        - Jobs supported
        - Family Loans (mortgage and/or consumer loans to households)
        - Housing Units
        - Small/Family Businesses
    - Education and Learning
        - Services
    - Food, Health and Well-being
        - Level of access to quality food
    - Leveraging Power
        - Philanthropic giving for vulnerable children
        - Dollars leveraged through adopting mission-driven investing strategies
- Beneficiaries (number)
    - Families Served
    - Vulnerable Children Served

The mission-driven investing dashboard has been only as reliable as the data collected from investees. From the outset of investment discussions, the mission-driven investing team worked to make clear the Foundation's requirement for social metrics and to explore with potential investees whether and how they can provide the needed reporting. The agreement to report is generally formalized in investment documents, and all parties understand that meeting the obligation requires effort on both sides – investees to report reliable data and the Foundation to analyze and make sense of the reports.

Along with quantitative metrics from the dashboard, the Kellogg Foundation's social metrics are designed to include stories that convey the experience of creating, accessing, and benefiting from improved conditions; from the Foundation's investees, partners, and the families and children those organizations serve. The stories capture diverse settings and voices, and seek to understand efforts and relationships that may not achieve stated goals as well as the ones that do.

Learning

Learning, says Foundation CEO Sterling Speirn, is "the profit of our activities." To make the most of each mission-driven investing experience, learning must be an objective, structured activity that can be shared throughout the organization. And that is precisely what the mission-driven investing team set out to do.

Routinely, the PMT takes time to capture lessons learned through its mission-driven investing experience. Early start-up lessons include:

- **Organizational readiness is a must**. When the Kellogg Foundation started its mission-driven investing program, there was a lot going on in the Foundation, including keen introspection and a definite awareness that the practice of giving must evolve to stay relevant - a powerful combination.
- **A champion is critical.** It made a big difference that CEO Sterling Speirn was ready, willing, and able to be a driving force at a high level, not just by pushing for the first January 2007 discussion with the Foundation's Board of Trustees but also by being willing to serve as a member of the mission-driven Investment Committee.
- **A pragmatic focus on navigating politics and process helps**. The team's strong, focused pragmatism helped it thread the many needles of internal process and politics required to make mission-driven investing work. Having staff with the determination, skills, and this kind of focus - not getting overly obsessed with or distracted by the minutiae of the issues and investments - was essential. So was having *a* pragmatic, focused process with a bias toward action, rather than toward a theoretical, ideological process.
- **Understanding the environment makes a difference.** The Foundation's staff took time to do its homework, scanning past efforts and the potential deal flow. This systematic approach to learning from the market and past experience accelerated the team's progress both internally and externally.
- **Internal and external divisions of labor are beneficial**. The division of labor between internal and external team members, along with close integration across the board, made a big difference. All members of the team were focused in a practical way on the same goal—coming up with a solid program that was right for the Foundation.
- **Focusing on the "what" and the "how," and not the "why" is critical.** It is easy to get caught up in the various cases, rationales, and goals of mission investing. Fortunately, the Kellogg team spent very little time on the broader existential issues. The team kept the focus firmly on the ground. The "what" challenge was to pick a set of issues that were mission bull's-eye for the Foundation and that were investable. The "how" aspect was about finding the right set of actors and then executing successfully. Putting some stakes in the ground on the "what" was key to making the "how" effective. There was so much potential complexity and so many moving targets that taking the "why" off the table and nailing down some "whats" allowed for a tight, doable focus on the "hows."
- **Program integration is desirable but it doesn't just happen.** Integrating this new tool and type of capital into our overall mission, and thus the Foundation's programming staff, has been an exciting aspect of mission-driven investing work. It also takes real thought and work. It is an ongoing process to determine the ability mission-driven investing has to complement, support, and push our programmatic thinking. Right now we are seeing the interest and capacities of program staff more focused on developing and

refining mission-driven investing program priorities (through our scanning work) versus bringing forward potential deals/investments.

- **The right talent and team are essential.** Given the range of skills, capabilities, and outlooks required, mission-driven investing needs a hybrid team of deeply experienced staff with institutional knowledge and history, strong ties to key program and finance areas, and extensive outsourced help for finding and executing deals.

The greatest learning, though, continues to come from doing (action learning).